

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:EEE:EOET:EO3

PLR-125821-19

Date:

May 22, 2020

Taxpayer =
Date =
State =
Statute =

Association =
Insurer =

Dear :

This letter responds to a letter from your authorized representative, dated October 10, 2019, and subsequent correspondence requesting a ruling that Taxpayer's income is excludable from gross income under section 115 of the Internal Revenue Code (Code). Taxpayer represents the facts as follows.

FACTS

Taxpayer is a nonprofit corporation incorporated on Date under the laws of the state of State. It was organized in accordance with Statute, which establishes a system through which county governments and other governmental entities in State ("Participating Governmental Entities") can obtain, among other benefits, group health insurance for their employees. Prior to the enactment of the above-referenced statute, Association performed activities like Taxpayer's current activities, albeit on a smaller scale. Taxpayer represents that Association is an instrumentality of the county governments of State and that Association's income is excludable from gross income under section 115 of the Code.

In order to carry out its statutory purpose, Taxpayer selects a single insurance company (Insurer) to provide health insurance and administrative services to the Participating Governmental Entities and their employees. Taxpayer selects Insurer based on the

company's ability to provide the Participating Governmental Entities and their employees the best value, coverage, and range of services. Taxpayer also considers the extent to which Insurer can help the Participating Governmental Entities provide medical and hospital attention to inmates in their custody, as required by State law. Taxpayer retains a consultant to monitor Insurer's competitiveness as compared to other health insurance companies that operate in State. Taxpayer can terminate its arrangements with Insurer at any time following a specified notice period.

Taxpayer and Insurer have negotiated three agreements under which Insurer agreed to provide: (1) group health insurance coverage to the employees of the Participating Governmental Entities; (2) stop loss insurance and administrative services to the Participating Governmental Entities that maintain self-funded health plans for their employees, including claims services and access to Insurer's physician network; and (3) insurance administrative services to the Participating Governmental Entities regarding the provision of medical services to inmates of county jails, including claims services and access to Insurer's physician network.

Taxpayer represents that its activities on behalf of the Participating Governmental Entities, as dictated by the governing statute, enable the Participating Governmental Entities to negotiate as an integrated unit and to receive employee health insurance coverage and services at lower costs than if the Participating Governmental Entities obtained such insurance coverage and services separately.

Insurer pays Taxpayer monthly fees under each agreement in exchange for Taxpayer's activities that help governmental entities in State become (and remain) Participating Governmental Entities. The Participating Governmental Entities pay all premiums and fees directly to Insurer. Employees of the Participating Governmental Entities pay their share (if any) of the premiums to their employers who in turn pay Insurer.

Taxpayer's programs are limited to State county governments and governmental bodies created by the State state legislature or by a State county ordinance, including State public authorities, commissions, and boards. Taxpayer and Association also participate in Taxpayer's programs.

Taxpayer's revenues primarily consist of the payments it receives from Insurer under the three agreements. Its revenues also include earnings received on a fund it maintains to stabilize premium volatility. Taxpayer is not regulated under State insurance law.

No part of Taxpayer's assets may be distributed to any private person other than to pay reasonable expenses for the administration of its programs. Upon dissolution, Taxpayer's assets must be distributed to the Participating Governmental Entities or to Association.

Taxpayer is governed by a seven-member board of directors. Each director must be actively engaged (or previously actively engaged) in county government and be an employee of a Participating Governmental Entity or Association. Association manages Taxpayer under a contract for services.

LAW AND ANALYSIS

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision thereof.

Rev. Rul. 77-261, 1977-2 C.B. 45, holds that income generated by an investment fund that is established by a state to hold revenues in excess of the amounts needed to meet current expenses is excludable from gross income under section 115(1) of the Code because such investment constitutes an essential governmental function. The ruling states that the statutory exclusion is intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of an entity engaged in the operation of a public utility or the performance of some governmental function that accrues to either a state or political subdivision of a state. The ruling explains that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and that are within the ambit of a sovereign to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under section 115(1) of the Code because the organization is performing an essential governmental function. The revenue ruling states that the income of such an organization is excludable from gross income so long as private interests do not participate in the organization or benefit more than incidentally from the organization. The benefit to the employees of the insurance coverage obtained by the member political subdivisions was deemed incidental to the public benefit.

Taxpayer was created under a state law intended to facilitate the provision of health insurance to employees of governmental entities located in State. Taxpayer also helps governmental entities in State comply with their obligation to provide medical services to inmates in their custody. Taxpayer's activities enable individual governmental entities to obtain employee insurance coverage and inmate services from Insurer at rates and fees that are lower than would be available if the entities acted separately. The provision of health insurance to employees of governmental entities and medical services to state and municipal inmates is an essential governmental function, as is helping those governmental entities protect their financial integrity. See Rev. Rul. 90-74 and Rev. Rul. 77-261.

Taxpayer's income accrues to political subdivisions of State. Private interests benefit only incidentally. See Rev. Rul. 90-74. In no event, including upon dissolution, will Taxpayer's assets be distributed or revert to any entity that is not a state, a political subdivision of a state, or another entity the income of which is excludable from its gross income by application of section 115(1) of the Code.

RULING

Based on the information and representations submitted on behalf of Taxpayer, we conclude that because Taxpayer derives its income from the exercise of an essential governmental function, and because Taxpayer's income accrues to a state or a political subdivision of a state, Taxpayer's income is excludable from gross income under section 115(1) of the Code.

The ruling contained in this letter is based on information and representations submitted by or on behalf of Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party, and on the understanding that there will be no material changes in the facts described above. While this office has not verified any of the material submitted in support of the request for a ruling, the material is subject to verification upon examination. The Associate office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the course of the transaction. See Rev. Proc. 2020-1, section 11.05.

This letter does not address the applicability of any section of the Code or Regulations to the facts submitted other than with respect to the sections specifically described, and, except as expressly provided in this letter, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item of income discussed or referenced in this letter. Specifically, no opinion is expressed or implied regarding the applicability of the Health Insurance Portability and Accountability Act of 1996 (HIPAA), or the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA).

This ruling is directed only to Taxpayer. IRC section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, if Taxpayer files its returns electronically, Taxpayer may satisfy this requirement by attaching a statement to its return that provides the date and control number of this letter ruling.

Sincerely,

Kenneth M. Griffin
Branch Chief
Office of the Chief Counsel
(Employee Benefits, Exempt Organizations,
and Employment Taxes)

cc: